SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Corbett, et. Al. Analyst: Marion Mann DeJong Bill Number: AB 2596

Related Bills: See Prior Analysis Telephone: 845-6979 Amended Date: 05/11/2000

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Manufacturers' Investment Credit/Extends to Electric Power Generation Using Natural Gas

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _________________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 3, 2000, STILL APPLIES.

_____ OTHER - See comments below.

SUMMARY OF BILL

This bill would modify the Manufacturers' Investment Credit (MIC) to include taxpayers engaged in businesses relating to fossil fuel electric power generation. The business activities of these taxpayers are described in North American Industry Classification System (NAICS) Manual Code 221112.

SUMMARY OF AMENDMENT

The May 11, 2000, amendments modified the definitions of qualified property and manufacturing to limit the power generation activities to power generation by natural gas. The amendments also made technical changes recommended by the department. The "Effective Date," "Legislative History," and current law discussion in "Specific Findings" from the department's analysis of the bill as amended April 3, 2000, still apply. The remainder of that analysis is replaced with the following.

SPECIFIC FINDINGS

This bill would modify the definition of qualified taxpayer to include businesses relating to fossil fuel electric power generation. These businesses are described in NAICS Manual Code 221112, as follows:

> Establishments primarily engaged in operating fossil fuel powered electric power generation facilities. These facilities use fossil fuels, such as coal, oil, or gas, in internal combustion or combustion turbine conventional steam process to produce electric energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Johnnie Lou Rosas	6/6/00
_____ N	_____ OUA	__X__ PENDING		

This bill would modify the definition of qualified property to include tangible personal property and capitalized labor costs for constructing such property. The qualified property would have to be used by the taxpayer in fossil fuel electric power generation businesses but only with respect to activities related to electric power generation using natural gas. In addition, qualified property would include special purpose buildings and foundations, including capitalized labor costs for constructing such buildings or foundations, for taxpayers engaged in electric power generation activities using natural gas.

This bill also would modify the definition of "manufacturing" to include the electric power generation using natural gas.

Policy Considerations

This bill would benefit transactions for which binding contracts already exist and would not be limited to benefit only future business decisions. Contracts in electric power generation transactions entered into after January 1, 1994, but prior to enactment of this bill, would qualify for the credit. According to the author's staff, this bill will be amended to resolve this issue.

This bill would expand the definition of manufacturing to include the generation of electricity by natural gas. As a result, taxpayers who qualify for the MIC under existing law for manufacturing activities could claim the MIC for auxiliary activities that satisfy this expanded definition of manufacturing. For example, assume a manufacturing plant that includes on its premises a co-generation facility that produces electricity to run the manufacturing line. Under current law, this co-generation facility is properly treated as an auxiliary establishment under the SIC Manual and is assigned the same SIC Code as the manufacturing activity. However, since the generation of electricity is not a qualified activity for MIC purposes under existing law, the costs attributable to the co-generation facility would not qualify for the MIC. However, such activities would qualify under the manufacturing definition provided by this bill.

Implementation Considerations

- Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

- It is unclear under current law whether electricity constitutes "tangible personal property" so that the general manufacturing process definitions under the statute are applicable. It may be advisable to provide a specific definition of the manufacturing process for electricity to determine the points at which the manufacturing process begins and when the property has been altered into its completed form to avoid disputes between taxpayers and the department.

- Although the definitions of qualified property and manufacturing were modified to restrict electric power generation to electric power generation by natural gas, the definition of qualified taxpayer was not modified. The author might consider making a corresponding modification to the definition of qualified taxpayer.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 2596 As Amended 5/11/2000		
For Taxable/Income Years Beginning 1/1/2000		
Assumed Enactment After 6/30/2000		
Fiscal Years		
(In Millions)		
2000-01	**2001-02**	**2002-03**
-$2	-$3	-$4

This analysis, does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

The revenue losses decreased from $4 million, $6 million and $7 million for fiscal years 2000/01, 2001/02 and 2002/03, respectively, because the May 11, 2000, amendments restricted qualified property to property used in electric power generation by natural gas.

Tax Revenue Discussion

The revenue impact of this credit would depend on the amount of qualified costs incurred and the tax liability of qualified taxpayers.

Qualified costs were estimated from a U.S. Census Bureau survey of capital expenditures by the industries in SIC codes 4911, 4931 and 4939 for 1997. Qualified costs were then factored down to reflect NAICS Code 221112, which is an industry subgroup of the above SIC codes and the percentage of cost attributable to natural gas. The 1997 numbers were grown to approximate 2000 and beyond. The credit use rates, taken from the microsimulation model of California tax returns, were then applied to derive the aggregate credit use. The fiscal year cash flow patterns are based on our analysis of how manufacturers adjusted their tax payments to reflect the reduction in liability resulting from the current law MIC.

This estimate does not include losses resulting from qualified taxpayers as defined under current law that might receive additional credit for activities that would qualify under the definition of manufacturing provided by this bill. Such losses cannot be quantified since the taxpayers engaged in the production of electricity, but whose primary business is manufacturing, cannot be identified.

BOARD POSITION

Pending.